

**Office of Chief Counsel
Internal Revenue Service
memorandum**

CC:SB:CPillitteri
POSTS-115550-04

date: May 3, 2004

to: Howard Oglesby, SB/SE Compliance

from: Ronald D. Pinsky, Acting Tax Litigation – Examination Manager (SB/SE)

subject: I.R.C. § 7605(b) and ASFRs

This is in response to your request for our advice regarding whether determinations and assessments of tax liability under the Automated Substitute for Return (ASFR) program are examinations for purposes of I.R.C. § 7605(b).

ISSUES

1. Whether determinations and collections of tax liability under the ASFR program are examinations for purposes of I.R.C. §7605(b).
2. If they are examinations for purposes of I.R.C. §7605(b), what are the consequences under I.R.C. §7605(b) of a subsequent reexamination of the taxpayer's books and records.

CONCLUSIONS

1. Determinations and collections of tax liability under the ASFR program are not examinations for purposes of I.R.C. §7605(b).
2. If they are examinations for purposes of I.R.C. §7605(b), the taxpayer waives any rights under I.R.C. §7605(b) by failing to object to the reexamination or voluntarily consenting to the reexamination. If the taxpayer objects to the reexamination, the Service may proceed with the reexamination so long as it follows its reopening procedures.

DISCUSSION

Issue 1

The ASFR program requires compliance by taxpayers who have not filed individual income tax returns but owe a significant income tax liability. Under the ASFR program, the Service determines and assesses the correct tax liability by: (1) securing a valid income tax return from the taxpayer, or (2) computing tax, penalties, and interest based upon Information Reporting Program (IRP) information submitted by payers, as well as other internally available information. I.R.M. § 5.18.1.2.

I.R.C. § 7605(b) restricts the Service from unnecessarily or repetitively examining a taxpayer's books and records by providing as follows:

No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

Policy Statement P-4-3, I.R.M. § 1.2.1.4.1, addresses reopenings and additional inspections of a taxpayer's books and records. The Service's policy is not to reopen any case closed after examination to make an adjustment unfavorable to the taxpayer unless: (1) there is evidence of fraud, malfeasance, collusion, concealment, or misrepresentation of a material fact; (2) the prior closing involved a clearly defined substantial error based on an established Service position existing at the time of the previous examination; or (3) other circumstances exist that indicate that failure to reopen would be a serious administrative omission. The Policy Statement sets forth the authorization requirements for reopenings and additional inspections.

The Policy Statement clarifies that not all contacts with a taxpayer are considered to be examinations or reopenings. Contacts with a taxpayer to verify or adjust a discrepancy between the taxpayer's tax return and information returns are not examinations or reopenings. Also, contacts to verify a discrepancy disclosed by an information return matching program may include inspection of the taxpayer's books and records to the extent necessary to resolve the discrepancy; those contacts are not considered to be inspections within the meaning of I.R.C. § 7605(b).

Rev. Proc. 94-68, 1994-2 C.B. 803, elaborates upon Policy Statement P-4-3 and applies "to all cases, regardless of type of tax, in which the prior audit and conference action, if any, did not extend beyond the jurisdiction of the office of the District Director. It does not apply to cases previously closed after consideration by Appeals Offices or District Counsels." The Revenue Procedure addresses three circumstances which are relevant to the subject of this opinion:

1. The Revenue Procedure provides that a contact with a taxpayer to verify or adjust a discrepancy between the taxpayer's tax return and an information return is not an examination, inspection, or reopening.
2. The Revenue Procedure provides that a contact to verify a discrepancy disclosed by an information return matching program may include inspection of the taxpayer's books of account, to the extent necessary to resolve the discrepancy, without being considered an examination, inspection, or reopening within the meaning of I.R.C. § 7605(b).
3. The Revenue Procedure provides that the adjustment of an unallowable item, or an adjustment resulting from other types of service center correction programs, is not considered to be an examination. Therefore, a subsequent examination is not considered to be a reopening of a case closed after examination.

The goal of the ASFR program is to secure a valid income tax return from the taxpayer or, barring that, to compute tax, penalties, and interest based upon IRP and other internally available information. The Service does not conduct a full-scale examination or inspection of the taxpayer's books and records in the ASFR program. The contacts with the taxpayer through the ASFR program are in the nature of verifying discrepancies disclosed by an information return matching program, which is not considered to be an examination, inspection, or reopening for purposes of I.R.C. § 7605(b). Therefore, the determination and assessment of tax liability under the ASFR program generally is not an examination for purposes of I.R.C. § 7605(b).

There could be instances in which a determination and assessment of tax liability originating in the ASFR program constitutes an examination for purposes of I.R.C. § 7605(b). For example, in response to a contact from the Service through the ASFR program, a taxpayer could submit a return, but the return may claim itemized deductions that are questionable; in that case, the Service might wish to thoroughly examine the taxpayer's books and records to ascertain whether the taxpayer is entitled to the claimed deductions. It is our understanding that in these instances the case is transferred to a Tax Compliance Officer or Revenue Agent for an examination. In these instances, an examination has occurred for purposes of I.R.C. § 7605(b). If it is later determined that an additional examination is necessary, the Service can follow the procedures for reopenings and additional inspections set forth in Policy Statement P-4-3 and Rev. Proc. 94-68.

Issue 2

I.R.C. § 7605(b) does not prohibit reexaminations, but limits them to instances where the taxpayer requests the reexamination or where the Service notifies the taxpayer in writing that the reexamination is necessary. The Service may reopen a case closed after examination to make an adjustment unfavorable to the taxpayer if: (1) there is evidence of fraud, malfeasance, collusion, concealment, or misrepresentation of a

material fact; (2) the prior closing involved a clearly defined substantial error based on an established Service position existing at the time of the previous examination; or (3) other circumstances exist that indicate that failure to reopen would be a serious administrative omission. When a properly authorized reopening letter is sent, the Service may reexamine the taxpayer's books and records.

Even if a properly authorized reopening letter is not sent, the taxpayer waives any rights under I.R.C. §7605(b) by failing to object to the reexamination or voluntarily consenting to the reexamination. See, e.g., *Moloney v. United States*, 521 F.2d 491 (6th Cir. 1975); *Rife v. Commissioner*, 41 T.C. 732 (1964); *Rice v. Commissioner*, T.C. Memo. 1994-204). If the taxpayer objects to the reexamination, the Service may proceed with the reexamination so long as it follows its reopening procedures.

If you have further questions regarding this matter, please feel free to contact Charles Pillitteri of my office at extension 3-7671.